STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Commonwealth Edison Company	)	
	)	
Petition for expedited approval of implementation of a market-based alternative tariff, to become effective on or before May 1, 2000, pursuant to Article IX and Section 16-112 of the Public Utilities Act	)	Docket No. 00-0259
	)	(cons.)
Central Illinois Public Service Company Union Electric Company	)	Docket No. 00-0395
Petition for approval of revisions to market value tariff, Rider MV	)	
Illinois Power Company	)	
	)	Docket No. 00-0461
Proposed new Rider MVI and Revisions to Rider TC	)	

Direct Testimony of

Robert R. Stephens

On Behalf of

Illinois Industrial Energy Consumers

August 2000
Project 7354 & 7379

BRUBAKER & ASSOCIATES, INC.
St. Louis, MO 63141-2000

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Direct Testimony of Robert R. Stephens

Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A Robert R. Stephens; 1215 Fern Ridge Parkway, Suite 208, St. Louis, MO 63141-2000.

Q BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A I am a consultant in the field of public utility regulation with the firm of Brubaker & Associates, Inc., energy, economic and regulatory consultants.

Q PLEASE STATE YOUR QUALIFICATIONS AND EXPERIENCE.

A These are included as Appendix A.

Q ON WHOSE BEHALF ARE YOU TESTIFYING?

A I am testifying on behalf of the Illinois Industrial Energy Consumers (IIEC). The IIEC is a group of large industrial customers taking service from Commonwealth Edison Company (ComEd or Edison) and Illinois Power Company (Illinois Power or IP)[1].

Although IIEC has not intervened in the Ameren market value index case, the Illinois Commerce Commission (ICC or Commission) may want to consider applying some of its policies uniformly across all three utility cases.

Q WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A I will address several issues relating to the market value index approaches of ComEd and IP, as outlined in the Index. While some of my comments will apply equally to these utilities, others may be applicable only to one of the utilities and are designated as such.

Q WHAT ARE YOUR CONCLUSIONS?

A I conclude that, from a technical viewpoint, the Companies' proposals fail to meet certain of the criteria required for Commission approval of the tariffs. Namely, the proposals only

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[1] Collectively, ComEd and IP will be referred to as "the Companies."

consider a subset of the market in establishing the market prices and that the "markets" identified by the Companies are not markets in which their retail customers buy electric power and energy.

I also conclude that IP's proposal to update values each month, especially in conjunction with its lead times associated with switching service to an alternate supplier or to Power Purchase Option (PPO) service, has the potential to create confusion and logistical difficulties.

Finally, I conclude that IP's policy of limiting the availability of PPO service to customers that have transition charges greater than zero is unreasonable in light of IP's market index proposal. I also conclude that PPO contracts entered into prior to the effective date of IP's tariffs (assuming such tariffs are allowed to go into effect) should be allowed to run their full 12-month duration based on the neutral fact-finder based prices and that they not be terminated in the event that the transition charge changes to zero mid-contract.

Q PLEASE BRIEFLY DESCRIBE THE COMED AND IP PROPOSALS.

A The proposals are described in the companies' filings in these cases. I will attempt to describe the most noteworthy features. Briefly, the proposals seek to replace the currently used neutral fact finder (NFF) measures of market value with measures of market value based on combinations of forward market price information for on-peak prices and historical market price information for off-peak prices. The Companies contend that their approaches are superior to the NFF process.

Both proposals use monthly bilateral 5x16 forward market price information for on-peak prices, obtained primarily by observing certain electronic trading services. IP's proposal utilizes industry trade publication information as an additional source for pricing information on forward monthly products. The proposals utilize combinations of actual trades and paired bid and offers, based on hierarchies defined in the tariffs.

Both proposals utilize published historical 1x8 day ahead price information for the off-peak prices.

In the case of ComEd, pricing data are obtained twice yearly, corresponding to two separate applicable periods, based on a customer's commencement date. Customer transition charges and PPO prices are based on prices developed for the applicable periods, with prices reset each May, regardless of commencement date.

In the case of IP, pricing data are obtained monthly to develop transition charges and PPO prices for customers commencing service the next month. Once the prices and resulting charges are established for a customer, they are in effect for 12 months.

Both proposals utilize publicly available hourly pricing information from the PJM market to convert the flat 16-hour on-peak prices into shaped prices over the applicable on-peak periods.

Other aspects of the proposals will be described, as necessary, hereinafter.

I. USE OF MARKET INDEX APPROACH

Q WHAT IS THE BASIS FOR THE COMED AND IP PROPOSALS?

A Section 16-112(a) of the Public Utilities Act (Act) states as follows:

> "The market value to be used in the calculation of transition charges as defined in Section 16-112 shall be determined in accordance with either (i) a tariff that has been filed by the electric utility with the Commission pursuant to Article IX of this Act and that provides for a determination of the market value for electric power and energy as a function of an exchange traded or other market traded index, options or futures contract or contracts applicable to the market in which the utility sells, and the customers in its service area buy, electric power and energy, or (ii) in the event no such tariff has been placed into effect for the electric utility, or in the event such tariff does not establish market values for each of the years specified in the neutral fact-finder process described in subsections (b) through (h) of this Section, a tariff incorporating the market values resulting from the neutral fact-finder process set forth in subsections (b) through (h) of this Section."

According to counsel, the Commission must determine whether the tariffs proposed by the Companies meet the criteria listed in subpart (i) quoted above.

Q FROM A TECHNICAL PERSPECTIVE, WHAT ARE THE SALIENT POINTS TO BE ADDRESSED?

A From a technical viewpoint, it appears that the Commission will need to determine whether the methods proposed by the Companies adequately represent the market to be measured and whether the market to be measured is one in which the utility sells and the customers in its service area buy electric power and energy.

Q FROM A TECHNICAL VIEWPOINT, DO YOU BELIEVE THE UTILITY APPROACHES MEET THE CRITERIA OF SECTION 16-112(a)?

A No, I do not. The so-called "market" measured by the Companies is actually a subset of the larger wholesale market. Also, while the Companies (or at least affiliates of the

Companies) may sell power in this "market," it is not the market in which customers in their service areas buy electric power and energy.

Q WHAT DO YOU MEAN BY YOUR STATEMENT THAT THE MARKET MEASURED BY THE COMPANIES IS ONLY A SUBSET OF THE WHOLESALE MARKET?

A The wholesale market is, and has been, a market involving many kinds of transactions and many kinds of contracts. Some of the transactions are long-term in nature, extending for several months or even years into the future.[2] Other transactions are intermediate in nature, lasting one or a few months. These are the types of transactions (or at least bids and offers) observed on a forward basis and used for on-peak pricing in the Companies' proposals. Still other transactions are much shorter term in nature, lasting only a few hours or days. One of these types of transactions is the 1x8 day ahead transactions observed on a historical basis and used by the Companies for off-peak prices. In addition, there may be still other types of transactions that do not fit neatly into the three categories I have just described.

As stated previously, under the Companies' approaches, only one of the three types of transactions for on-peak power is observed and only one of the three types of transactions for off-peak power is observed. Hence, the Companies are considering only a subset of the transactions in the market.

2 These are the types of transactions reported to and used by the neutral fact-finder in the process referenced in Section 16-102(a) subpart (ii) quoted above.

Q WHY IS THIS DISTINCTION YOU RAISE IMPORTANT?

A This is important because of the effect on transition charges that utilities are allowed to collect. As used in the calculation of transition charge, the market value is intended to represent the value for the electric power and energy that the electric utility would have used to supply all of the customers' electric power and energy requirement, as a tariffed service.

In my opinion, the 5x16 monthly forward market observations for on-peak prices and historical 1x8 daily market observations for off-peak prices are not a suitable representation of what the electric utility would have used to supply its bundled tariff customers' requirements. This is because utilities have the option to purchase or sell freed up power and energy in any of the market categories that I have defined. I would not expect, nor have the companies represented, that they would purchase or sell all freed up on-peak power and energy in the 5x16 monthly forward market and all freed up off-peak power and energy in the 1x8 daily market.

Q DO YOU KNOW THE COMPOSITION OF THE OVERALL WHOLESALE MARKET, IN TERMS OF PERCENTAGES, COMPRISED BY EACH OF THE THREE CATEGORIES OF TRANSACTIONS THAT YOU HAVE DESCRIBED ABOVE FOR ON-PEAK AND OFF-PEAK POWER SALES?

A No. The Companies were asked for information useful in deriving these percentages in a series of IIEC data requests, but thus far have not provided the needed information for

either of the proposed market hubs.[3] I believe this to be valuable information to provide to the Commission and hope to do so as more information becomes available. Obviously, if the observations relied upon by the Companies do not comprise the market, the less reliable would be the market value determination.

Q PLEASE EXPLAIN YOUR EARLIER STATEMENT THAT THE MARKET INDICES DO NOT REFLECT THE MARKET IN WHICH CUSTOMERS IN THE COMPANIES' SERVICE AREAS BUY ELECTRIC POWER AND ENERGY.

A To my knowledge, not a single customer in either ComEd's or IP's territory buy their electric power and energy needs via the markets measured by ComEd and IP. In order to do so, a customer would have to be registered as a Customer Self-Manager, and even then there would be complications surrounding the requirement that power be purchased from a certified Alternative Retail Electric supplier or Illinois utility. To my knowledge, there is not a single operating Customer Self-Manager to date.

Consequently, to my knowledge, there simply is not yet in existence a market in which the utilities sell and the customers in their territories buy electric power and energy that excludes retail transactions. Certainly the submarkets observed by the Companies do not meet that standard.

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3 ComEd proposes to use Into ComEd and Northern MAIN for on-peak and off-peak pricing, respectively. IP proposes to use Into Cinergy and Lower MAIN for on-peak and off-peak pricing,

Q ARE YOU AWARE OF ANY SOURCE OF COMPETITIVE PRICING INFORMATION THAT INCLUDES TRANSACTIONS INVOLVING BOTH THE UTILITIES AND RETAIL CUSTOMERS?

A Yes, the 2000 NFF report. The 2000 NFF reviewed data from 5,953 actual contracts,[4] many of which involved retail customers, and reported its findings (revised final) to the Commission on August 15, 2000.

Q DOES THE NFF REPORT INCLUDE OBSERVATIONS OF EACH OF THE THREE CATEGORIES OF TRANSACTIONS THAT YOU MENTIONED EARLIER?

A Probably not. The NFF only receives summaries of actual contracts entered into several months prior to the effective period. Hence, because of the nature and timing of the information reported to the NFF, its report probably includes only long-term or intermediate term transactions. Therefore, in my opinion from a technical viewpoint, the NFF report, by itself, would not fully meet the criteria for a market value index tariff listed in subsection (i) of Section 16-112(a) of the Act, were it subject to that subsection. I mention this for reasons that will be made clear later in this testimony.

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respectively.

[4] It is interesting to contrast this number of actual contracts to the number of actual contracts observed by the utilities as part of their market index proposals, as discussed in the Direct Testimony of IIEC witness Dr. Linda E. Bowyer.

Q THE COMPANIES ARE CRITICAL OF THE NFF PROCESS AND RESULTS IN MAKING THEIR MARKET INDEX PROPOSALS. DOES THE 2000 NFF REPORT MEET ALL OF THEIR CRITICISMS?

A I do not believe so. Although the 2000 NFF report is a result of similar processes to the prior reports, the Companies had not had the opportunity to review the 2000 report prior to filing their testimony in the instant dockets, as it was not released in final form until August 15, 2000.

The following table summarizes the market values reported by the 1999 and 2000 NFFs.

Summary of 1999 and 2000 Market Prices as reported by the NFF

Period	1999 Price	2000 Price
Summer:		
On-Peak	$32.14	$43.22
Off-Peak	$29.58	$29.82
Non-Summer:		
On-Peak	$27.79	$34.88
Off-Peak	$26.41	$25.97

As can be seen, overall the prices are up in the 2000 NFF report, as compared to the 1999 report and prices are more temporally differentiated.[5] These correspond to two of the criticisms of the Companies. The Companies may change some of their opinions as a result of the 2000 NFF report.

[5] It is worth noting that the NFF shortened the defined on-peak period from 16 hours in the 1999 NFF report to 13 hours in the 2000 NFF report.

Q DO YOU HAVE ANY COMMENTS REGARDING THE CONCEPT OF USING MONTHLY FORWARD MARKET PRICE INFORMATION AS AN INDICATOR OF MARKET VALUE FOR OTHER TRANSACTION CATEGORIES?

A Yes. Even if one assumes that the processes used by the Companies adequately capture the monthly forward wholesale markets, this does not mean that other categories of transactions are adequately represented. Especially in recent months, measures of market forward prices from several months ago have proven to be poor indicators of actual spot prices.

Q PLEASE EXPLAIN.

A The price of a forward monthly contract is expected to reflect expectations of a combination, or average, of the spot prices within the period. A shining example of how wrong the forward pricing can be, as compared to spot pricing, are the prices quoted during the time ComEd's Applicable Period A market prices were developed.

ComEd's Applicable Period A market observation window is the 20 business day period ending March 22, 2000. Although I am not privy to the data used by ComEd in developing its Applicable Period A prices (as those data are not available to any parties besides ComEd), trade press indications were that forward market prices for the summer months, as reported back in March, grossly overstate the spot prices actually experienced. For example, the reported forward price quote for a July/August Into ComEd forward

contract during the observation window was in the range of $151-$155 per MWh[6]. In contrast, the weighted average of the daily prices that actually occurred during July was only about $35 (using the same 5x16 criteria as embodied within the monthly forward contract) and for August (through August 28) was about $39 per MWh. The combined weighted average for the two-month period was about $37 per MWh, or less than a quarter of the forward price quote observed in March.[7]

Some may argue that actual spot prices are irrelevant in this analysis and that only the price of the forward product itself is relevant. However, such an argument ignores the fact that short-term transactions are likely to occur and that revenues will be affected by conditions present when the short-term deals are done. Such an argument also ignores the fact that the Companies themselves rely on actual spot prices, but for off-peak power.

Q GIVEN YOUR POSITIONS THAT THE MARKET IS COMPRISED OF SEVERAL CATEGORIES OF TRANSACTIONS AND THAT THE SUBMARKETS OBSERVED BY THE COMPANIES ARE NOT MARKETS IN WHICH CUSTOMERS BUY POWER AND ENERGY, IS THERE THE POTENTIAL FOR AN INDEX THAT BETTER ADDRESSES THESE SHORTCOMINGS?

A Setting aside any legal arguments that might prohibit such an approach, there is a possible approach for developing an index that addresses these points. An example is a

[6] Power Market's Week – *Daily Price Report*.
[7] The same information sources indicate similar results in the Into Cinergy market, which IP proposes.

combination index approach that utilizes a measure of long-term transactions (perhaps based on NFF report information), intermediate transactions (perhaps similar to the instant utility proposals) and short-term transactions (perhaps relying on historical daily published data, similar to what the Companies propose to use for off-peak power) and weights them according to market composition. IIEC would be willing to work with the Companies and Staff to develop such an approach.

IV. TIME PERIOD OF CALCULATIONS

B. IP 12 MONTH ROLLING CALCULATIONS

Q DO YOU HAVE ANY CONCERNS REGARDING IP'S PROPOSAL TO ESTABLISH NEW MARKET VALUES EACH MONTH FOR CUSTOMERS BEGINNING DELIVERY SERVICE?

A Yes. While I am not opposed theoretically to IP's approach, it does raise some logistical issues. Given the frequent updating of the values, it may be confusing to some customers as to what the applicable transition charges will be and could potentially lead to customers making decisions based on values that are subject to change or are wrong.

In addition, due to the notice provisions for taking certain types of service, such as PPO service, there can be circumstances where a customer would have to sign up for PPO service prior to knowing the transition charges that will be imposed. This problem is exacerbated by IP's policy of not making PPO service available to customers who have a zero transition charge. In that instance, a customer who suddenly becomes eligible for

PPO service due to a shift in market prices might not know of his eligibility until after it is already too late to sign up for PPO service.

IP may also want to consider a modification to its proposal whereby it secures the market data each month, but only actually changes the tariffed market value energy charges if there is an overall change in the values exceeding some certain threshold level (e.g., 5 percent). This would lend greater stability to the process and potentially reduce the number of changes imposed on customers.

V. TRANSITIONAL ISSUES

A. TARIFF DESIGN ISSUES

i. INITIAL IMPLEMENTATION

Q DO YOU HAVE ANY CONCERNS REGARDING THE INITIAL IMPLEMENTATION OF THE TARIFFS PROPOSED BY THE COMPANIES?

A Yes. One particular concern is regarding PPO contracts, especially as it pertains to IP. If a customer begins PPO service using NFF-based prices, the customer should be allowed to continue the contract for the full 12 months with NFF-based prices, even though the NFF-based prices will be updated effective January 1, 2001. These customers will have entered into the contracts expecting a certain type of pricing structure and it is only fair that they be allowed to continue through the duration of their initial contract.

IP's position on how it will handle this matter is not entirely clear and IP has invited suggestions regarding this point. Currently, IP is considering an approach that would use the 2000 NFF market values (applicable in 2001) until the customer's

anniversary date, at which point they would convert to the market value index. (See IP Exhibit 3.1, p. 8.) My recommendation affirms this approach, but goes a step further in that it would provide that NFF-based pricing continue through the term of the 12-month PPO contract which, theoretically, can differ from a customer's anniversary date.

Another issue has to do with whether a NFF-based PPO customer becomes ineligible for service if his transition charge goes to zero mid-contract. In that event, I believe the customer should be allowed the option of continuing the contract through the end of the contract term. Although the savings may diminish once the transition charge goes to zero, there can be many reasons why a customer will not want to be terminated suddenly. IIEC's legal position on this matter will be provided in its briefs in this case.

VI. PPO ISSUES

Q DO YOU HAVE ANY COMMENTS CONCERNING THE UTILITY PROPOSALS AS THEY RELATE TO PPO ISSUES?

A Yes, my comments are directed at IP's proposal. Based on my review of the PPO tariffs, it is clear that IP does not allow PPO service to commence for a customer whose transition charge is equal to zero. IIEC's legal position on this policy as well will be provided in its briefs in this case. My comments go to the policy aspects of IP's position.

Q PLEASE CONTINUE.

A The implication of IP's proposal in this case is that IP must believe that market values derived pursuant to the market value index approach are adequately reflective of the

market prices faced by IP and its customers. Assuming that is the case, there is no logical rationale for IP to prefer selling its potentially freed up power into the wholesale market at a given price or selling it to its own delivery service customers via the PPO at the same prices.

In contrast, ComEd offers PPO service to all delivery service customers, regardless of whether their transition charge is greater than zero. I also note that part of ComEd's proposal in this case was to make wholesale power and energy supply available to other suppliers at prices based on the derived market value index. This latter concept was supported by Staff witness Christ in the earlier proceedings in Docket No. 00-0259. Mr. Christ recommended that the Commission condition the approval of ComEd's petition on making the "wholesale" option available as long as Rider PPO (Market Index) is available. (Christ Direct Testimony at p. 8.) The policy of a utility providing power at the market index price serves as a protection against intended bias in the market value derivation.

Q WHAT IS THE IMPACT ON CUSTOMERS OF IP'S POLICY IN THIS REGARD?

A The effect of IP's policy is to withhold potential savings from customers. To illustrate this, consider two customers who are entitled to receive individually calculated transition charges. Under normal circumstances, PPO service can be expected to yield approximately a 5 mills per kWh savings as compared to bundled energy prices, whether

a customer's transition charge is 20 mills or a fraction of 1 mill. However, as soon as the transition charge becomes zero, its savings opportunities are greatly affected.

Consider two nearly identical hypothetical customers: Customer A has a positive transition charge of 1/10 of 1 mill per kWh while Customer B would have a transition charge of negative 1/10 of 1 mill per kWh, but for the fact that transition charges are not allowed to be negative. Therefore, his transition charge is set at zero. Under IP's policy, Customer A would have access to a 5 mills per kWh savings off of his base energy rate, whether is comes from the market or IP, via PPO service. Customer B's savings, if any, will depend entirely on the market. If IP would sell PPO service to Customer B at the same price as to Customer A, Customer B would have access to a 4.9 mill savings from his base rate and not have to depend entirely on power from the market.

Q IN YOUR HYPOTHETICAL, WOULD NOT CUSTOMER B BE ABLE TO OBTAIN A POWER AND ENERGY PRICE FROM THE COMPETITIVE MARKET THAT IS COMPARABLE TO PPO SERVICE FROM IP?

A Not necessarily. There may not be multiple competitive options available to the customer in the IP territory. However, even if there are options available, the price a customer may get in the market may not be as favorable as PPO service due to a variety of reasons, including transmission service issues, unfavorable market conditions or the simple fact that alternate suppliers know they would not have to compete against the PPO option.

Consequently, nearly identical customers could have widely disparate power cost options simply due to IP's policy of not allowing PPO service to customers with zero

transition charges, even though IP should be largely indifferent as to providing the service, if it has confidence in its market index approach.

Q DOES THIS CONCLUDE YOUR TESTIMONY?

A Yes.

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Qualifications of Robert R. Stephens

Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A Robert R. Stephens. My business mailing address is P. O. Box 412000, 1215 Fern Ridge Parkway, Suite 208, St. Louis, Missouri 63141-2000.

Q PLEASE STATE YOUR OCCUPATION.

A I am a consultant in the field of public utility regulation with the firm of Brubaker & Associates, Inc., energy, economic and regulatory consultants. My title is Senior Consultant.

Q PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A I graduated from Southern Illinois University at Carbondale in 1984 with a Bachelor of Science degree in Engineering. During college, I was employed by Central Illinois Public Service Company in the Gas Department. Upon graduation, I accepted a position as a Mechanical Engineer at the Illinois Department of Energy and Natural Resources. In the summer of 1986, I accepted a position as Energy Planner with City Water, Light and Power, a municipal electric and water utility in Springfield, Illinois. My duties centered on integrated resource planning and the design and administration of load management programs.

From July 1989 to June 1994, I was employed as a Senior Economic Analyst in the Planning and Operations Department of the Staff of the Illinois Commerce

Commission (ICC). In this position, I reviewed utility filings and prepared various reports and testimony for use by the ICC. From June 1994 to August 1997, I worked directly with a Commissioner as an Executive Assistant. In this role, I provided technical and policy analyses on a broad spectrum of issues related to the electric, gas, telecommunications and water utility industries.

In May 1996, I graduated from the University of Illinois at Springfield with a Master of Business Administration degree.

In August 1997, I joined Brubaker & Associates, Inc. as a Consultant. Since that time, my duties have centered on participating in the analysis of and providing expert testimony in various utility rate and restructuring matters in several states and the solicitation and evaluation of power supply proposals for multiple clients.

The firm of Brubaker & Associates, Inc. provides consulting services in the field of energy procurement and public utility regulation to many clients, including large industrial and institutional customers, some utilities, and on occasion, state regulatory agencies. More specifically, we provide analysis of energy procurement options based on consideration of prices and reliability as related to the needs of the client; prepare rate, feasibility, economic and cost of service studies relating to energy and utility services; prepare depreciation and feasibility studies relating to utility service; assist in contract negotiations for utility services; and provide technical support to legislative activities.

In addition to our main office in St. Louis, the firm also has branch offices in Kerrville, Texas; Plano, Texas; Denver, Colorado; and Chicago, Illinois.